First Accounts: Product Design Requirements and Options

Purpose

The 2001 funding round of the Bank Enterprise Award (BEA) Program invites applications from insured depository institutions seeking to offer or expand their provision of low-cost bank accounts to “unbanked” individuals and families (i.e., people who currently do not have a banking relationship with a mainstream financial institution). This document provides institutions that are considering offering such First Accounts as part of their BEA Program applications with general guidance on product design requirements and options. The Notice of Funds Availability (“the Notice”) for the 2001 funding round of the BEA Program authorizes the provision of First Accounts as a Qualified Activity and sets forth the required First Account features. The Notice also encourages applicants to consider additional features that may increase First Accounts’ appeal and utility to unbanked consumers.

Background on the First Accounts Initiative

The President’s FY 2001 budget request includes $30 million for the Treasury Department to implement an initiative that aims to increase access to mainstream financial institutions and their services for currently unbanked individuals and families. The 1998 Survey of Consumer Finances conducted by the Federal Reserve Board indicates that 22 percent of Low- and Moderate-Income households (about 8.4 million families) do not have any kind of bank account. Some of these families receive Federal benefits and are eligible to open an Electronic Transfer Account (ETA) at a participating financial institution. Approximately half, however, may not be eligible for an ETA. Moreover, such families may lack access to an affordable transaction account at a mainstream financial institution or may not understand the benefits of account ownership. In making First Accounts a Qualified Activity, the Fund is seeking to provide an incentive for insured depository institutions to increase their provision of low-cost bank accounts to Low- and Moderate-Income individuals in Distressed Communities.

First Account Requirements

To receive consideration as a First Account activity under the BEA Program, an account must:

- Be an individually owned account at a Federally-insured depository institution;
- Permit a minimum of four cash withdrawals and four balance inquiries per month, which are included in the monthly fee, through any combination of automated teller machine (ATM) transactions and/or over-the-counter transactions;
- Allow access to the depository institution’s on-line point-of-sale network (if it has one);
- Require no minimum balance except as required by Federal or state law;
- Provide a monthly statement; and
- Provide the same consumer protections available to the institution’s other account holders.

Optional Considerations in Developing a First Account Product

All First Accounts must offer the required features listed above in order to be considered a Qualified Activity under the BEA Program. In designing a First Account product, BEA Program applicants may also wish to consider how offering additional features could reduce costs, increase utility to consumers, and increase demand for these low-cost account products.

The following recommendations, informed by research conducted by the Treasury Department, the Federal Reserve, and others, were prepared by the Treasury Department's Office of Community Development Policy, and have not been independently researched by the Fund. Applicants may wish to consider the following features in designing First Accounts:

- Low Monthly Fee: Keeping the monthly servicing fee charged to account holders as low as feasible will make a First Account more appealing to unbanked consumers. Treasury research found that, for a typical unbanked Federal benefit recipient, monthly fees were an important factor in the overall decision to enroll in an ETA-like product. Lowering the monthly fee from $4 to $3 on an account like the ETA was predicted to increase overall participation by 33 percent.[1]

- All-Online Design and Flexible Account Opening Standards: Creating an "all-online" First Account that permits no check-writing and reduces or eliminates off-line debits can reduce the risk of overdraft for account holders and institutions, thereby reducing costs to both parties. Studies indicate that at least half of currently unbanked families had a bank account at some time in the past.[2] Some of these now-unbanked families may have exited the financial services mainstream due to experiences with bounced checks or other off-line debits that led to overdrafts and high associated fees. BEA Program applicants may wish to consider how design of a First Account product could minimize the possibility of overdrafts. To the extent that First Accounts incorporate an all-online design, BEA Program applicants may also wish to consider making these accounts available to all consumers, including those who may have had overdraft problems in the past.

- Direct Deposit: Working with businesses located in Distressed Communities to use an institution's Direct Deposit payroll service may increase account ownership because such employers can encourage their low-wage employees to enroll in First Accounts. At the same time, Direct Deposit can save employers money over issuing paper checks to employees. Similarly, costs to a financial institution for processing a Direct Deposit are significantly lower

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[1] *ETA Conjoint Research, Final Report and Market Model*, Dove Assoc., May 1999 (available online at www.fms.treas.gov/eta/conjoint.pdf). The Dove market model, which allows the user to estimate participation (or "take-up") rates for accounts with different features at different price points, is available at www.fms.treas.gov/eta/ETAMODEL.XLS.

[2] A 1997 study by John Caskey at Swarthmore College found that 71 percent of heads of household without deposit accounts had held a checking or savings account in the past. (See Caskey, John. 1997. *Lower Income Amercians, Higher Cost Financial Services*. Filene Research Institute & Center for Credit Union Research, University of Wisconsin-Madison.) The Federal Reserve's analysis of the 1998 Survey of Consumer Finances indicated that 48 percent of families without a checking account had owned such an account in the past (See Kennickell, Arthur B., Martha Starr-McCluer and Brian J. Surrette. 2000. "Recent Changes in Family Finances: Results from the 1998 Survey of Consumer Finances." *Federal Reserve Bulletin* (January): 1-29).

than for handling a paper check deposit.[3] BEA Program applicants might also consider working with free tax preparation services, including IRS Volunteer Income Tax Assistance sites, in Distressed Communities to encourage recipients of Federal and state tax refunds that include an Earned Income Tax Credit (EITC) to have that refund deposited directly into a new account. Refund recipients can receive their payments quickly and securely and institutions can receive a large initial deposit (e.g., families claiming the EITC in 1998 were refunded an average of $1,660).[4]

- Payment of Interest on Balances: Offering the payment of interest on First Accounts balances may increase the appeal of these accounts to unbanked families. Financial institutions may, at their option, pay interest on ETA balances. Research commissioned by Treasury showed that the payment of a passbook rate of interest on an electronic account like the ETA significantly increased the number of unbanked Federal benefit recipients that signed-up for such an account.[5] Other Treasury research estimates that the higher balances would, for the most part, offset the cost of paying interest on ETA balances that account holders would be expected to maintain.[6]

- Bill Payment: Including a limited number of money orders (issued either electronically or through a teller) in the monthly service charge may increase the utility and appeal of First Accounts to unbanked consumers. An all-online First Account design would likely preclude check-writing capabilities; however, account holders would probably still seek a convenient, low-cost method to make long-distance payments. Studies indicate that unbanked families frequently use money orders to pay bills.[7] These money orders could be bundled with stamped envelopes (which many check cashing outlets sell with money orders) to further facilitate customer payments. BEA Program applicants may also wish to consider deploying technologies in Distressed Communities that would allow First Accounts holders to pay their bills online (e.g., ATM or internet bill payment).

[3] In the context of EFT '99, Treasury found that the cost of processing a Direct Deposit for a Federal payment is $0.01, versus $0.42 for processing and mailing a paper check.
[4] Individual Income Tax Returns, Preliminary Data, 1998. *Statistics of Income Bulletin*, Spring 2000. Internal Revenue Service.
[5] See *ETA Conjoint Research.*
[6] *ETA Initiative: Optional Account Features*, Dove Associates, June 1998 (available online at www.fms.treas.gov/eta/features.pdf). Dove estimated that for both large and small financial institutions, paying a passbook rate of interest (2 percent) on ETA balances would add only $0.06 per month to costs.
[7] Caskey found that 69 percent of surveyed households without deposit accounts had purchased more than 10 money orders in the previous year, and that 39 percent had purchased more than 30 (Caskey 1997).